

Message Text

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C O N F I D E N T I A L CAIRO 1424

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E.O. 11652: GDS
TAGS: USEGJC, EAID, IMF
SUBJ: ASSISTANCE TO EGYPT: IMF AGREEMENT IS STILL A POSSIBILITY

REF: CAIRO 1236

1. SUMMARY. WHILE A NUMBER OF POTENTIALLY SERIOUS OBSTACLES STILL EXIST, THERE IS POSSIBILITY THAT EGYPT WILL BE ABLE TO CONCLUDE AGREEMENT FOR IMF STANDBY IN NEXT SEVERAL WEEKS. FUND APPEARS TO HAVE SHOWN FLEXIBILITY IN ADJUSTING TO NEW CIRCUMSTANCES AND DEP PM KISOUNI APPEARS TO HAVE THE COURAGE AND TENACITY TO STAND BY HIS AUSTERITY BUDGET, ITSELF SOMEWHAT MODIFIED AS RESULT OF RIOTS. WILLINGNESS OF GOE AND PEOPLES ASSEMBLY TO SUPPORT HIS POSITION REMAINS KEY UNANSWERED QUESTION. END SUMMARY.

2. GUNTER AND DICKIE OF IMF MET WITH AMBASSADOR JAN. 25 FOR DISCUSSION OF CURRENT SITUATION, WITH PARTICULAR STRESS ON STATUS OF FUND'S NEGOTIATIONS WITH EGYPT. AID DIRECTOR BROWN AND ECONCOUNS PECK WERE PRESENT, AS WAS MR. HANS GERHARDT, WHO IS REPLACING DICKIE AS IMF'S MAN IN CAIRO.

3. GUNTER ACKNOWLEDGED THAT PRESS REPORTS STATING AN AGREEMENT HAD BEEN REACHED WERE PREMATURE, BUT MADE IT CLEAR THERE ARE STILL GOOD REASONS FOR HOPING THAT A STANDBY COULD
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BE CONCLUDED IN NEAR FUTURE. THE FUND HAS GONE A LONG WAY TO MEET THE EGYPTIANS, HE SAID, AND SINCE KAISOUNI IS STILL INTENT ON A REASONABLY TIGHT BUDGET, AN ACCOMMODATION IS POSSIBLE. GUNTER COVERED FOLLOWING ESSENTIAL POINTS.

4. BUDGET. AS INITIALLY PROPOSED, 1977 BUDGET CONTAINED A BANK-FINANCED DEFICIT OF ONLY LE150 MILLION. THIS FIGURE

HAD BEEN REACHED BY, INTER ALIA, REDUCING GOVERNMENTAL OUTLAYS IN SUPPORT OF PRICES OF VARIOUS COMMODITIES, CUTS WHICH PRESIDENT LATER ORDERED RESTORED, ALTHOUGH NOT WITH PRECISION. AS RESULT, BUDGET ITEMS FOR BASIC FOODSTUFFS AND UTILITY CLOTH WILL GO UP AN ESTIMATED LE 82 MILLION (FLOUR 42,, SUGAR AND RICE 11M, MAIZE 24M, BUGAZ 5M). SALARY INCREMENTS PLUS PENSION INCREASES HAVE PLACED TOTAL DEFICIT IN NEIGHBORHOOD OF LE300 MILLION, A FIGURE IMF IS WILLING TO ACCEPT.

5. IMPORT AT PARALLEL RATE-PRICE EQUALIZATION FUND. IN WHAT WAS DESCRIBED AS A POSSIBLE NEGOTIATING PLOY, KAISOUNI WANTS TO EXCLUDE LE 165 MILLION WORTH OF IMPORTS BY MINSUPPLY FROM THE LE 455 THAT GOE HAD EARLIER AGREED WOULD BE SHIFTED TO PARALLEL RATE OF EXCHANGE IN 1977. EGYPTIANS WOULD APPARENTLY BE WILLING TO SHIFT FULL AMOUNT IF PRICE ADJUSTMENT MECHANISM COULD OFFSET THE RESULTANT INCREASED DOMESTIC PRICES. IMF HAS AGREED THAT PRICE FUND CAN BE INCREASED FROM EARLIER LE200 MILLION FOR 1977 (LE135 MILLION FOR FIRST SIX MONTHS, LE65 MILLION FOR SECOND) TO LEVEL OF LE300 MILLION. KAISOUNI, WHO FELT THAT LE 370 MILLION WOULD BE REQUIRED FOR THE PURPOSE, SETTLED FOR THIS FIGURE, WHICH DICKIE SAID SHOULD COVER BOTH LE165 TO BE SHIFTED TO PARALLEL RATE AS WELL AS SOME OF IMPORTS SHIFTED LAST MAY BY ABU ISMAIL.

6. INTEREST RATES. GOE HAS AGREED TO RAISE DOMESTIC INTEREST RATES BY ELIMINATING THE WITHHOLDING TAX (WHICH REDUCES CURRENT EFFECTIVE RATE TO ABOUT 3 PERCENT) AND ADDING ONE PERCENT, MAKING TOTAL OF 6 PERCENT
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ON TIME DEPOSITS. DISCUSSIONS WILL BE HELD LATER TO CONSIDER RAISING RATES AN ADDITIONAL ONE PERCENT IN ORDER TO APPROACH "INTERNATIONALLY COMPETITIVE LEVELS" AND ENCOURAGE INFLOW OF CAPITAL AS WELL AS DOMESTIC SAVINGS. SOME RESISTANCE IS EXPECTED FROM GOE BECAUSE OF THE IMPACT ON COSTS OF BORROWED MONEY ON GOVERNMENT AND PUBLIC SECTOR OPERATIONS.

7. BALANCE OF PAYMENTS. SITUATION HERE LOOKS BETTER THAN HAD INITIALLY BEEN PREDICTED, DUE LARGELY TO AN UNDERESTIMATION OF PRIVATE TRANSACTIONS AND REMITTANCES. DICKIE SAID OWN CURRENCY IMPORTS IN 1976, FOR EXAMPLE, HAD AMOUNTED TO \$425 MILLION AND WERE LARGER THAN EXPECTED. AS RESULT, FORECAST DEFICIT IS \$1.9 BILLION, WHICH VARIOUS FORMS OF "SPECIAL FINANCING" ARE EXPECTED TO REDUCE TO AN UNFINANCED GAP OF \$1,250 MILLION. (ABOVE CALCULATION INCLUDES BOTH \$500 MILLION FROM GODE AND THE KHARTOUM SUBSIDY BUT NOT RABAT SUBSIDY.) ANY NEW OR ADDITIONAL ASSISTANCE EGYPTIANS CAN OBTAIN WILL CLOSE THE GAP. (NOTE IBRD REPS HAD DIFFERENT FIGURES FOR UNFINANCED GAP.

REPORT ON THAT MEETING FOLLOWS SEPTEL.)

8. EXTENDED FUND FACILITY. GUNTER STRESSED ABOVE DETAILS APPLY ONLY TO A STANDBY AGREEMENT, IT IS MUCH TOO SOON TO WORK OUT DETAILS FOR AN EXTENDED FACILITY, AND GOE COULD NOT LIVE UP TO THE COMMITMENTS EVEN IF THE PAPERS WERE SIGNED. IF EGYPTIANS CAN GET THE INDUSTRIAL SECTOR ON PARALLEL RATE FOR IMPORTS, ACHIEVE NOT TOO INFLATIONARY A BUDGET, AND THEN DURING COURSE OF THIS YEAR WORK OUT MEDIUM TERM TARGETS AND GET READY FOR A UNITARY RATE OF EXCHANGE EARLY NEXT YEAR, THE EXTENDED FACILITY COULD LOGICALLY FOLLOW.

9. STANDBY AGREEMENT. GUNTER FEELS BEST POSSIBLE COMPROMISE HAS BEEN REACHED IN PRESENT CIRCUMSTANCES, AND SDR 125 MILLION SHOULD ACT AS INDUCEMENT TO GET GOE MOVING FORWARD IN RIGHT DIRECTION. HE RECOGNIZES THAT THERE IS STILL SOME WAY TO GO BEFORE FINAL PAPERS ARE SIGNED, BUT FEELS IMF HAS MADE A CONTRIBUTION TO SUPPORTING

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AND ENCOURAGING KAISOUNI'S STAND. TIMING OF NEXT STEPS IS UNCLEAR BUT FUND IS PREPARED TO ASSIST AS SOON AS NECESSARY STEPS ARE COMPLETED BY EGYPTIANS.

10. COMMENT. EMBASSY AGREES. THERE IS STILL SOME WAY TO GO, AND A NUMBER OF SIGNIFICANT THINGS WILL HAVE TO HAPPEN IF AGREEMENT IS TO BE REACHED, MOST OF THEM DEPENDING ON EXTENT TO WHICH KAISOUNI CAN CARRY PRESIDENT, GOE, PEOPLES ASSEMBLY, AND THE PEOPLE (AS PERCEIVED BY GOE AND PA).

11. PARTLY AS RESULT OF LACK OF DISTINCTION WITH WHICH TOP EGYPTIAN POLITICAL LEADERSHIP HANDLED RECENT PRICE INCREASES, THE ENSUING RIOTS, AND THE SUBSEQUENT SUSPENSION OF THE DECISIONS, KAISOUNI HAS EMERGED AS A MAN OF COURAGE AND TENACITY. DESPITE REACTIONS TO THE EARLIER MOVES, HE AND HIS ECONOMIC GROUP ARE STILL TRYING TO CONVINCE CABINET COLLEAGUES AND THE PEOPLES ASSEMBLY OF THE STARK NEED FOR DRASTIC ECONOMIC REFORM. EXTENT TO WHICH THEY CAN SUCCEED REMAINS TO BE SEEN, AND ON THIS DEPENDS THE POSSIBILITIES OF AN AGREEMENT WITH THE IMF, IMPORTANT IN ITSELF BUT OF GREATER SIGNIFICANCE IN TERMS OF EGYPT'S ECONOMIC FUTURE.

12. CRITICISM HAS BEEN LEVELLED, PERHAPS JUSTIFIABLY, FOR BALD AND CLUMSY MANNER IN WHICH PRICE INCREASES WERE HANDLED, AND KAISOUNI HAS BEEN GIVEN THE BLAME EVEN THOUGH POLITICAL GUIDANCE AND CONDITIONING SHOULD HAVE COME FROM PM SALEM. WHO HAS REMAINED MUM. BUDGET AND ALL IT ENTAILED WAS INITIALLY APPROVED BY THE CABINET, AND REVISIONS AS PROPOSED NOW TO IMF WILL HAVE TO CLEAR THIS HURDLE AGAIN, ONLY NOW THE MEMBERS CAN BE EXPECTED TO BE EVEN MORE GOOSEY. CABINET APPROVAL WILL MEAN THAT SADAT WILL BE FACED WITH THE DECISION, AND SINCE SALEM HAS

REPORTEDLY PREVENTED KAISOUNI FROM PRESENTING REALISTIC BRIEFING
ON THE SITUATION, IT IS DIFFICULT TO TELL HOW SADAT WILL REACT.
IF HE WERE TO BE CONVINCED FIRST, WHICH GUNTER SAYS KAISOUNI HOPES
TO ACCOMPLISH, HEARTS AND MINDS OF CABINET
WOULD PROBABLY FOLLOW, BUT THUS FAR PRESIDENT HAS NOT APPEARED
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WILLING TO LISTEN TO DETAILED INFORMATION ON THE SUBJECT AND HAS
GIVEN ONLY LIP SERVICE TO THE NEED FOR REFORM.

13. ANOTHER HURDLE IS PEOPLES ASSEMBLY, WITH 240 BRAND-NEW
MEMBERS, ONLY LIMITED UNDERSTANDING OF THE SITUATION, AND ONLY
PARTIAL RECOVERY FROM SHOCK OF FOOD RIOTS. ASSEMBLY HAS
BEEN INSISTING THAT BUDGET CUTS MUST COME FROM SOMETHING OTHER
THAN SUBSIDIES. KAISOUNI'S EXPLANATION THAT ONLY OTHER AREA
WHERE SUBSTANTIAL REDUCTIONS CAN BE MADE IS DEFENSE, EQUALLY
UNACCEPTABLE, HAS PRODUCED EXPECTED RESULT: DEFICIT, SAY
PARLIAMENTARIANS, MUST THEREFORE BE COVERED BY GREATER FINANCIAL
SUPPORT FROM ARABS AND OTHER DONORS. IT IS DIFFICULT TO FORECAST
WHAT ASSEMBLY WOULD DO WITH--OR TO-- RECAST BUDGET PROPOSED
BY KAISOUNI TO IMF, WHEN AND IF IT GETS THROUGH CABINET/PRESIDENT,
BUT PASSAGE OF THAT BUDGET IS BASIS ON WHICH FURTHER MOVEMENT TO-
WARD AN AGREEMENT IS BASED.

14. ON BASIS OUR APPRECIATION OF EVENTS, KAISOUNI IS ONLY SENIOR
GOE OFFICIAL SHOWING ANY GUTS AND A WILLINGNESS TO GRAPPLE
WITH THE ISSUES FACING EGYPT. HE SHOULD BE ENCOURAGED IN
HIS EFFORTS AND SUPPORTED IN THE STAND HE HAS TAKEN, AND
ANYTHING USG CAN ACCOMPLISH IN THIS REGARD WILL BE IN BEST
INTERESTS OF ALL PARTIES OVER LONG RUN.
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